Directorate of Intelligence
Office of African and Latin American Analysis

28 June 1982

NOTE FOR: Special Assistant to the DCI

[redacted] 25X1

Attached is the material which Mr. Casey requested on the Honduras economic situation. I have also included the material on the political situation which Al Wedemeyer provided for the package at your request.

[redacted] 25X1

Director

Attachment:
As stated

28 June 1982

HONDURAS

Honduras is plagued by mounting economic problems in a country whose standard of living is already Central America's lowest. Stagnating economic activity, high unemployment, and tightening government austerity measures could lead to serious political problems for the new Suazo government.

Background

Agriculture forms the backbone of the Honduran economy, traditionally accounting for over 30 percent of GNP and two-thirds of employment. Earnings from banana and coffee sales alone produce up to half of all export revenues. The government has not courted foreign investment aggressively, and deficient transportation and communications systems and a largely unskilled labor force have done little to attract manufacturing capital.

Despite its shallow economic base, Honduras was able to achieve solid development momentum in the late 1970's as a result of strong export earnings and a sizable government spending program. Average annual real GNP growth for 1976-79 exceeded 7 percent, substantially above the 5.2 percent of non-OPEC LDC's as a whole. Prices for traditional farm commodities were strong, and non-agricultural exports--such as non-ferrous metal ores and textiles--also made substantial gains. Government expenditures more than doubled in support of a reasonably successful program to improve transportation and upgrade social services.

Tegucigalpa was able to secure long-term soft loans to aid the expansion effort, and foreign debt reached over $900 million by 1979--almost triple 1976 levels.

The bubble burst in mid-1979 when the increase in world energy prices rapidly overtook price and volume gains for key exports. By 1980, the current account deficit was more than double that of 1978. With the vital export sector stagnating, the real GNP increase of 2.0 percent could not match the 3.4 percent population growth.

Tegucigalpa found it increasingly difficult to finance the soaring current account deficit. Alarmed by the rate of growth of public spending, the IMF suspended a $55.6 million, three-year Extended Fund Facility (EFF) in late 1979. Foreign banks, already made nervous by increasing unrest in Central America, cut back on new long-term financing. Tegucigalpa found it necessary to draw foreign exchange reserves down by approximately 30 percent during 1980.

Confidence plunged and total capital investment contracted by over 4 percent in real terms. Capital flight reached at least $40 million, exacerbated by events in Nicaragua and El Salvador.

Recent Economic Performance

Over the last eighteen months, the Honduran economic activity has stagnated. Low world market prices for major exports--coffee, bananas, lumber, and sugar--cut export earnings in 1981 and prospects are for a further decline this year. Regional and domestic instability have discouraged local and foreign investors, and capital flight has aggravated the already precarious balance of payments situation.

Honduras faces a $398 million current account deficit in 1982, slightly worse than last year, and a $121 balance of payments deficit. In addition to low world market prices, the recently imposed US sugar quota and changing import practices are beginning to pinch export revenues. The resulting foreign exchange shortage recently forced the central bank to impose new restrictions on imports and the use of foreign exchange. Nearly 40 percent of domestic production are dependent upon imports, intensifying production problems. Poor economic performance has pushed unemployment to at least 20 percent and underemployment to nearly 60 percent.

Fiscal Crunch

The Suazo administration inherited a difficult fiscal situation. The projected budget deficit of $100 million was unfinanced. To cope with the problem, the government introduced various austerity measures, including government employment reductions, that reduced the fiscal deficit to $35 million in late May. Emergency spending to repair the $15 million in recent hurricane and flood damage will once again push expenditures up, however.

With a tighter austerity program, Tegucigalpa is once again keeping inflation to the low 10 percent level that was achieved in 1981.

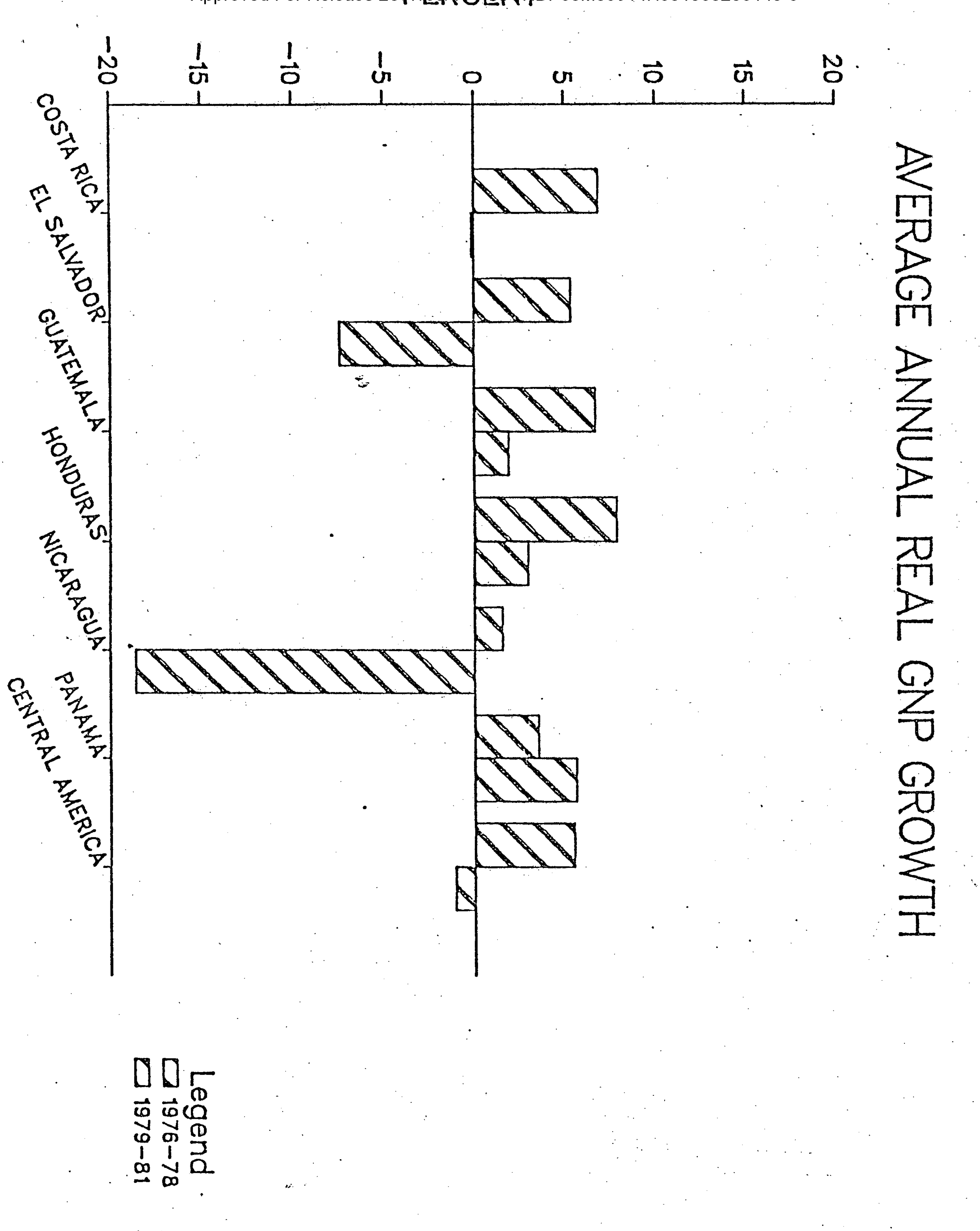
Negotiations with the IMF

Although the Honduran government reached agreement with the IMF in late May on an 18 month stand-by program for $87 million, Honduras has not yet signed the letter of intent. The IMF wants Honduras to reduce current expenditures by the central government, cut spending by public enterprises, and implement tax measures to increase revenues.

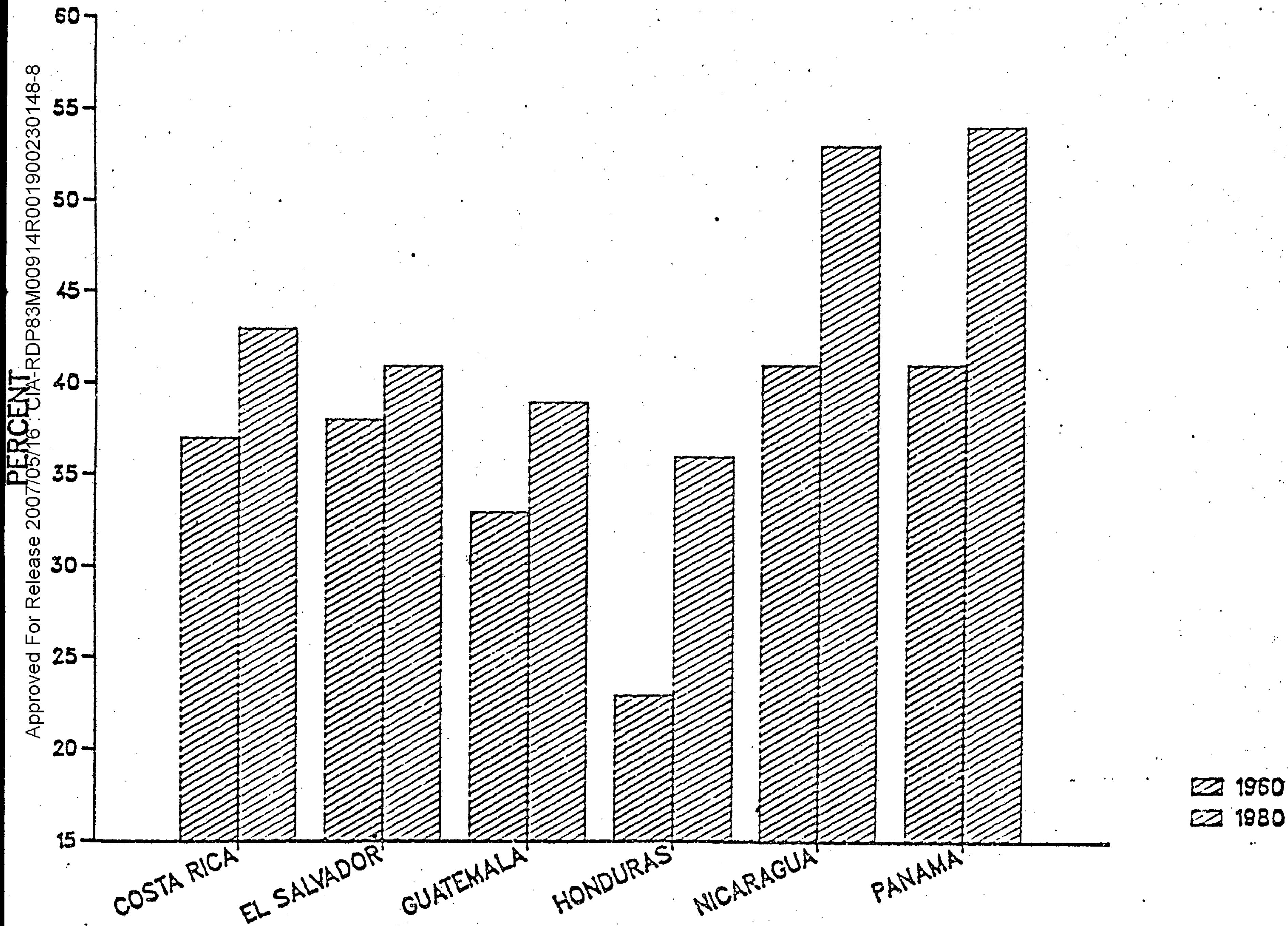
Tegucigalpa is asking the IMF for greater flexibility on the budgetary targets for 1982. Despite the austerity program, the government does not feel it is possible to balance the budget until 1983.

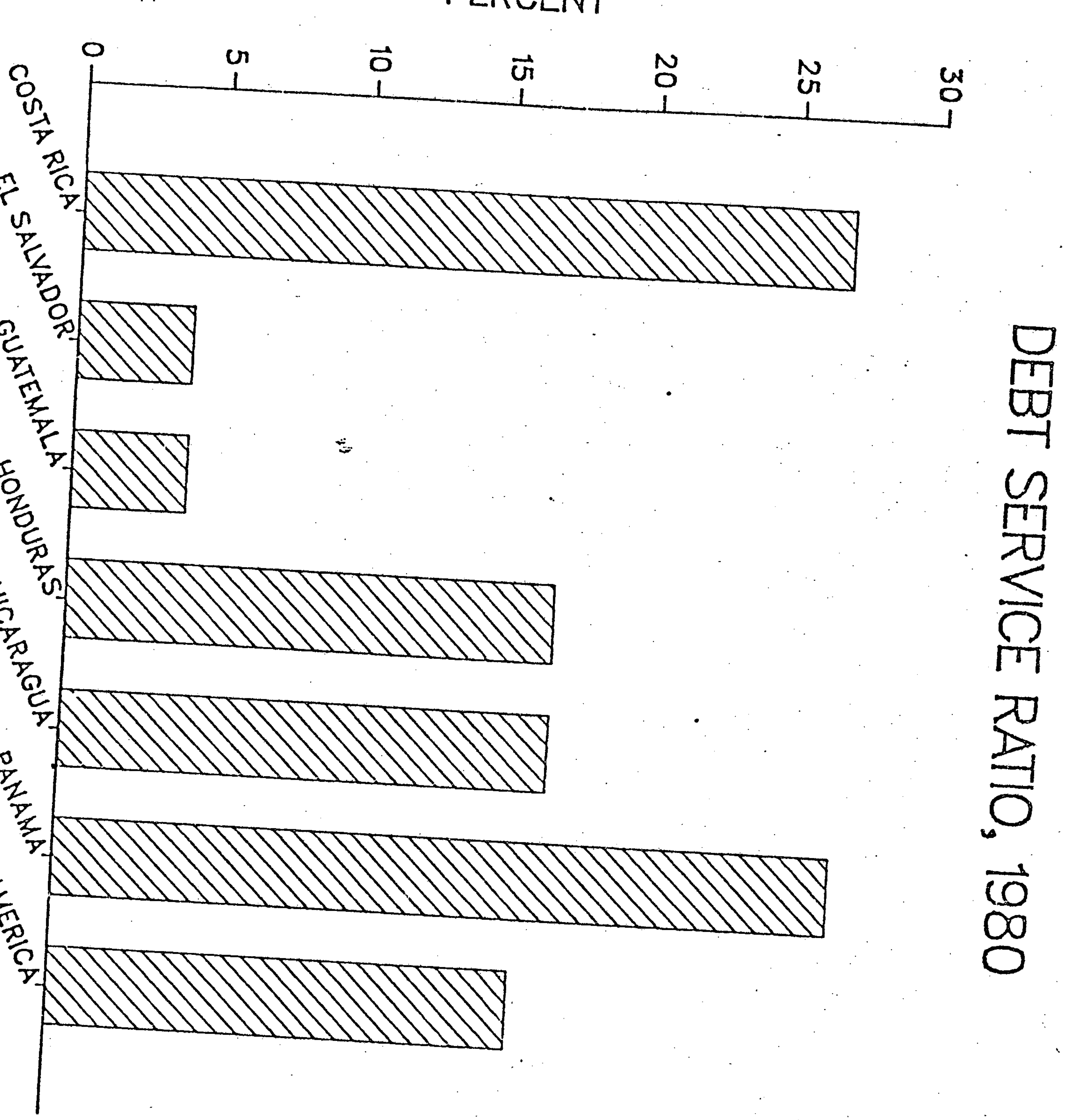
HONDURAS: SELECTED ECONOMIC AND SOCIAL INDICATORS

	1960	1970	1976	1977	1978	1979	1980	1981
Average Annual Real GDP Growth (percent)	-0.1	6.6	8.4	8.7	6.5	6.7	2.7	0.3
GDP per capita (US $)	181	274	403	465	526	604	688	703
Inflation (percent)	-1.8	2.8	4.9	8.3	5.7	18.0	20.0	10
Debt Service Ratio (percent)	NA	6.1 (1973)	13	13	14	19	17	20
Merchandise Trade Balance (Million US $)	-1.0	-25.2	-20.8	-20.3	-28.3	-33.3	-121.5	NA
Oil Imports as a Share of Exports (percent)	NA	NA	13.4	13.7	12.6	15.4	21.2	NA
Population Growth (percent)	2.8	7.7	3.6	3.8	3.6	3.5	3.7	3.5
Adult Literacy (percent)	45	—	60	—	—	—	—	—
Urbanization (percent)	23	—	—	—	—	—	—	36

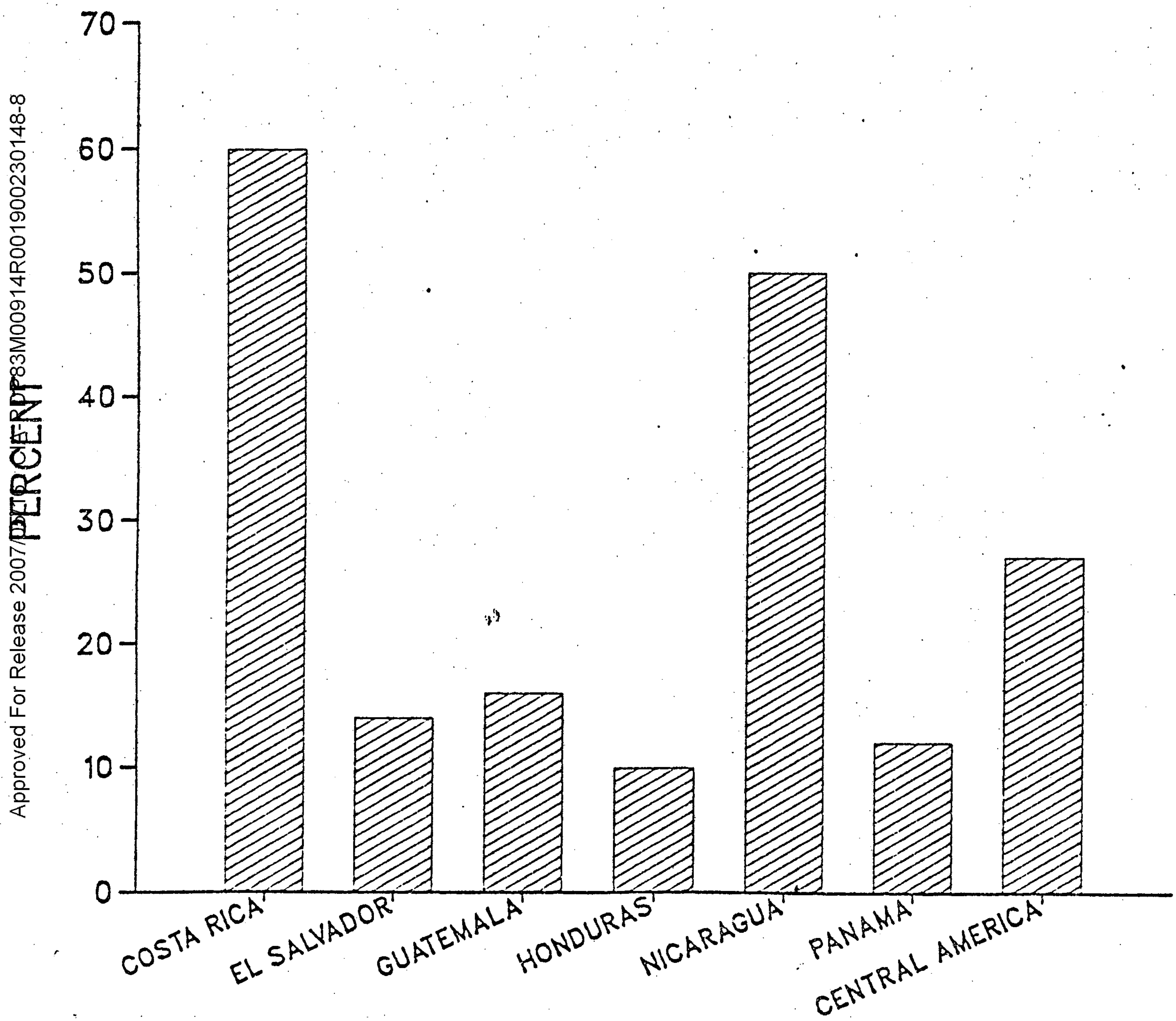

AVERAGE ANNUAL REAL GNP GROWTH
PERCENT
20
15
10
5
0
-5
-10
-15
-20
COSTA RICA
EL SALVADOR
GUATEMALA
HONDURAS
NICARAGUA
PANAMA
CENTRAL AMERICA
Legend
1976-78
1979-81

URBANIZATION

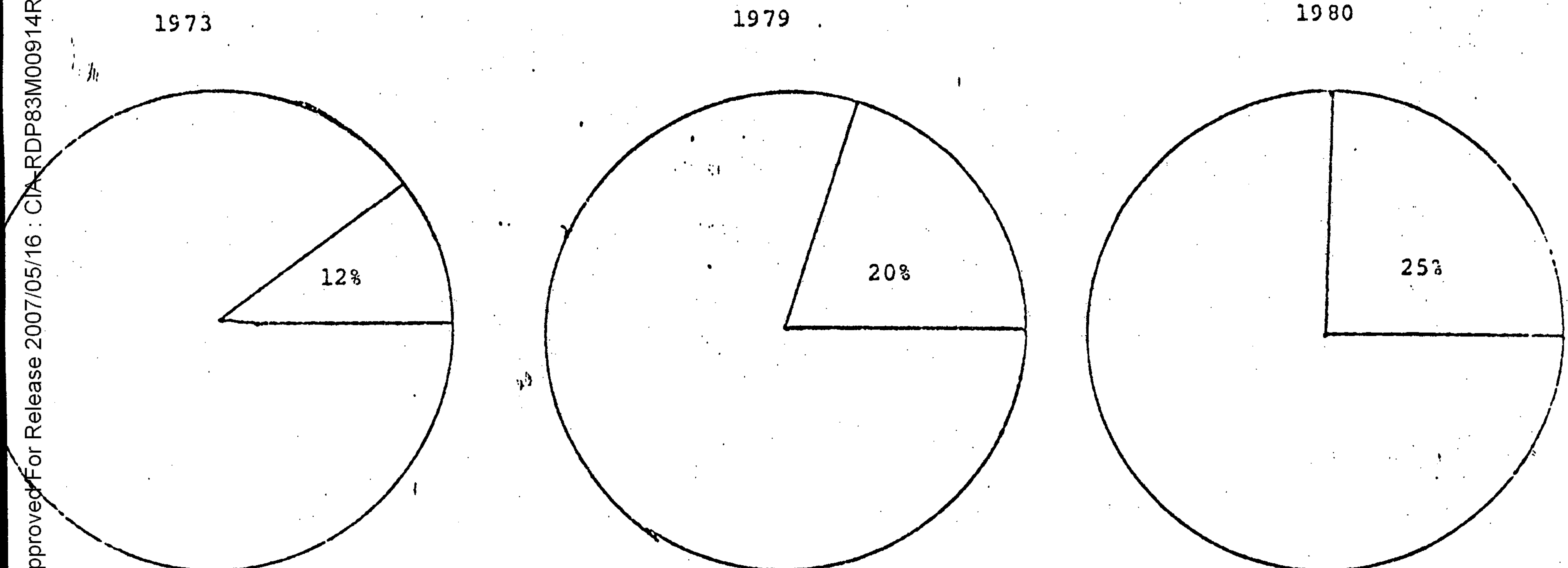



DEBT SERVICE RATIO, 1980
PERCENT
0
5
10
15
20
25
30
COSTA RICA
EL SALVADOR
GUATEMALA
HONDURAS
NICARAGUA
PANAMA
CENTRAL AMERICA

INFLATION, 1981



CENTRAL AMERICA: Oil Imports as a Share of Exports



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HONDURAS: CURRENT SITUATION, PERSPECITVES

Currently, the Republic of Honduras, should be the main subject of attention of Western powers and especially of the United States.

Honduras is situated in the center part of Central America adjacent to Guatemala, El Salvador and Nicaragua. Honduras has not only escaped the violence that affects its neighboring countries but also, in an effort worth imitating, has managed to carry out an honest and free electoral process that resulted in a civilian and democratic government based on justice.

After a decade of military rule, the Honduran people voted peacefully for the government that currently rules them.

Because it is essentially of popular origin, the government counts on the support of the different sectors of society and the support of the armed forces.

During its first three months in power, the new government has focused its efforts on the implementation of an honest and efficient administration, in order to regain credibility and trust both internally and externally.

Even though the government has found satisfactory solutions to its social and political problems, it has not, however, been able to solve the already existing critical economic problem which to a certain degree, has become more serious.

The new government, led by Dr. Roberto Suazo Cordova, has found the economic situation in Honduras at one of its worst critical stages in history. The Gross National Product (GNP) in 1981 showed a growth of only 0.3% which, compared with the demographic growth, translates into a deterioration of the per capita revenue.

One can observe that throughout the entire production structure, almost all sectors suffered a decline.

The excessive level of imports and the deterioration of commercial foreign exchange has absorbed most of the total expenditure, thus adversely affecting the public and private sector deficit, which increased to 600.6 million lempiras (approximately U.S. $300.3 million).

The reduction in government revenue derived from exports and the corresponding decrease of available foreign capital contributed very markedly to the lack of international monetary reserves. This in turn affected the level of imports.

The main problem which affects public investment is the large deficit of the Central Government which in 1982 will reach 481 million lempiras, equivalent to 8% of the GNP. 200 million of this amount cannot be financed.

The above situation resulted from the decrease in Central Government revenue, since the increase of indirect tax receipts was eliminated as a result of a reduction of direct taxes, specifically income taxes which decreased as a consequence of the stagnation of the private sector.

In the meantime, workers and farmers, housewives, students and professionals suffer the consequences of a recession and the effect of an imported inflation. This is causing great social problems and a certain lack of faith in the credibility of the newly elected democratic government.

Among the first priorities considered by the government of Dr. Suazo Cordova are the reduction of current expenditures, substantial improvements in the efficiency of Public Administration, a channeling of public investment resources by means of basic priority criteria, which will generate greater economic and social benefits and at the same time will be supportive of private investment. All of this means the substitution of new ethical values from the corruption and inefficiency of past administrations.

New measures have been taken to reduce the fiscal deficit and to effect an internal reorganization. This requires greater sacrifices, which unfortunately will conflict with the main objective of maintaining social stability through employment policies and basic welfare programs for the great majority of people.

We are currently working with the International Monetary Fund on ~~a large financial~~ agreement which will require further internal sacrifices. The government of Honduras, as far as possible, is willing to accept this; however, it is our duty to make sure that these tight measures do not reach extremes and cause popular disappointment, which could have dangerous repercussions and affect the political stability that we have so far achieved. The Honduran people desire more employment, improvement in the standard of living, better housing, better systems of health and education. Restrictions in these areas will only aggravate the current situation.

We are also taking steps for the renegotiation of the external debt. The current government will not be able to resolve this problem but neither can it allow the economy to suffer another setback. The economic crisis cannot be resolved overnight but it can be improved gradually.

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The private sector is the one which suffers the most from the current crisis and its consequences on employment. Several enterprises run the risk of closing because of a lack of capital and other business limitations.

President Reagan's new policy on the Caribbean basin is important and beneficial to our countries, but its effects will be felt in the medium and long term. Its success depends on the attitude taken by American businesses and other foreign investors, and their willingness to come to our countries and help in the production of consumer goods or to increase the manufacture of local goods. It will also depend upon the collaboration and commercial interest of these enterprises which will be involved in the marketing of consumer goods in all the American states.

The amount of direct economic aid contemplated by the U.S. President's program is too small. We have noticed, with dismay, that there is a lack of political decision to consider Honduras a special case. Currently, Honduras needs more direct aid (at least 100 million dollars) to be able to meet basic needs; otherwise the repercussions are unforeseeable, because the people of Honduras will feel cheated of the efforts made toward democracy and could thus become vulnerable to movements that feed international subversion.

We need to demonstrate that democracy works. We are absolutely convinced that a general disappointment can lead the people of Honduras to opt for other alternatives. When someone does not have the means to feed his family, he will be tempted to protest and fight against the system.

Military aid to the Armed Forces is also vital, since we cannot overlook its importance to the defense of our democratic system.

The President of the Republic, Dr. Roberto Suazo Cordova, in his message to the nation one month after his election, stated the following when referring to international aid, particularly from the U.S.: "A slow and insufficient economic aid could very well mean no aid, If we don't act fast, it could be too late."